STATE USURY LAWS AND THE FEDERAL RESERVE BANKS.

TO the American jurist, the field of the constitutional law presents perhaps some of the most difficult and baffling problems with which he is required to deal. Although certain principles have now become well established as part of our jurisprudence, new problems daily arise, the solution of which is often rendered exceedingly difficult on account of the complex system which exists in the United States by virtue of the dual sovereignties of the States and the Nation. Perhaps the most perplexing of these problems arise in connection with the activities of Federal agencies. To what extent are such agencies subject to the paramount authority of the Federal Government and to what extent may they be controlled by the sovereign will of the several States?

A matter of considerable importance has recently arisen with regard to the operations of the Federal reserve banks, which suggests a thoughtful consideration of this question. The usury laws of many States fix the maximum rates of interest which banks located therein may receive. The question has been raised as to whether such State laws control and limit the rates of interest and discount which the several Federal reserve banks may charge, or whether these banks are free to fix their own rates without regard to the State legislation. The Federal Reserve System is a Federal banking system created by virtue of an Act of Congress. The twelve Federal reserve banks are creatures of the Federal Government. It cannot now be questioned that Congress has the power to create such a Federal banking system and to endow it with such powers and functions as are necessary to enable it to effect its objects.[1] Congress having created the Federal Reserve System in the execution of its undoubted constitutional authority and having clothed the Fed-

[1] M'Culloch *v.* Maryland, 4 Wheat. 316; Osborne *v.* U. S. Bank, 9 Wheat. 738; Central National Bank *v.* Pratt, 115 Mass. 539, 15 Am. Rep. 138.

eral reserve banks organized thereunder with certain powers, among others, the power to establish rates of interest and of discount "subject to the review and determination of the Federal Reserve Board", any attempt on the part of a State to limit such rates is a direct challenge to the paramount authority of the Federal Government.

While it is evident that in its own field the Federal Government is supreme, it is difficult to determine the precise line where the power of the Federal Government ceases and the power of the State obtains. Ever since the decision in the early case of M'Culloch *v.* Maryland,[2] the broad issues involved have received much discussion, but the principles enunciated by the Supreme Court of the United States are often elusive and sometimes even difficult to reconcile. As Mr. Justice Miller once said, "the line which divides what is occupied exclusively by any legislation of Congress from what is left open to the action of the States is not always well defined, and is often distinguished by such nice shades of difference on each side as to require the closest scrutiny when the principle is invoked." [3]

The precise question at issue is one of novel impression. In order to reach a convincing solution, and at the same time throw some light upon the general issues involved, it seems desirable to analyze certain of the decisions of the Supreme Court which deal with the power of the States to control and regulate the operations of Federal agencies. The most apposite of these cases concern the effect of State laws upon the operations of national banks. It is well established that, except in so far as Congress has expressly made them applicable, the State usury laws are unconstitutional when sought to be applied to national banks.[4]

Section 5197 of the Revised Statutes [5] provides that a national bank may charge interest on any loan or discount at the rate allowed by the laws of the State in which the national bank

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[2] *Supra.*

[3] Waite *v.* Dowley, 94 U. S. 527, 533.

[4] Farmers & Merchants National Bank *v.* Deering, 91 U. S. 29; Central National Bank *v.* Pratt, *supra;* First National Bank *v.* Garlinghaus, 22 Ohio St. 429. The principle established in these cases recently was affirmed in Evans *v.* National Bank of Savannah, 251 U. S. 108, decided December 8, 1919.

[5] National Bank Act, Sec. 30.

is located and that where no rate is fixed by the State law, a rate not exceeding 7% may be charged. Section 5198 prescribes the penalties for charging a greater rate than that allowed in the preceding section. In view of these provisions it is settled that the State laws are relevant to determine the rate of interest, but beyond that they have no effect.

The effect of the State usury laws upon national banks was discussed at length in Farmers & Merchants National Bank *v.* Deering.[6] The New York Court of Appeals had held that as a matter of construction the penalties prescribed in the National Bank Act obtained solely where the laws of the State did not fix a maximum rate and that where, as in New York, a maximum rate was established, a national bank which exceeded that rate was subject to the penalties prescribed by the State law. On appeal, the Supreme Court of the United States reversed the decision of the New York court on both points, saying that the New York court had erroneously construed the National Bank Act, and that even under the construction given it, the State law could not obtain. There are expressions in the opinion which would seem to sustain the principle that, even in the absence of the Act of Congress, State usury laws could not limit the interest rates of a national bank, but the actual decision merely went to the extent of holding that where Congress has prescribed a maximum rate, its action is constitutional, and any conflicting legislation by the State is void so far as the national agency is concerned.[7]

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[6] *Supra.*

[7] The court evidently based its opinion in the Deering Case squarely upon the principle that a State can exercise no control over a national bank nor in any way affect its operation except as Congress may permit. It is submitted that this rule, without qualification, is too broad. In this connection it is interesting to note the decision of the Supreme Court in National Bank *v.* Commonwealth, 9 Wall. 353; and Waite *v.* Dowley, 94 U. S. 527. In the first case, a Kentucky statute required the cashiers of banks located in Kentucky to pay into the State treasury the tax assessed by Kentucky upon stockholders owning stock in such banks. The cashier of a national bank in Kentucky failed to comply with this act, and the State of Kentucky sued to recover the amount. The Supreme Court on appeal held the Kentucky act constitutional, saying that a national bank, although an instrumentality of the Federal Government, is not wholly withdrawn from the operation of State legislation, and that the agencies of the Federal Government are exempted from State legislation only so far as that legislation may interfere with or impair their efficiency in performing the functions by which they are designated

The principle established in the Deering Case was reaffirmed by the Supreme Court in Davis *v.* Elmira Savings Bank.[8] In this case it appeared that by virtue of a law of the State of New York, savings banks having deposits in any bank in New York which became insolvent obtained a prior claim upon the assets of the insolvent bank. The National Bank Act, however, required that the receiver of a national bank must pay all claims ratably. A national bank located in New York having become insolvent and having in its possession deposits of a savings bank, the New York Court of Appeals held that the savings bank, by virtue of the New York law, obtained a prior claim upon the assets of the insolvent bank. On appeal, however, the Supreme Court reversed this decision, holding that, as the two statutes covered the same subject-matter, the State statute must give way. The court said in part:

> "The question which the record presents is, does the law of the State of New York on which the Savings Bank relies conflict with the laws of the United States upon which the Comptroller of the Currency rests to sustain his refusal? If there be no conflict, the two laws can co-exist and be harmoniously enforced, but if the conflict arises; the law of New York is from the nature of things inoperative and void as against the dominant authority of the Federal Statute." [9]

These two cases seem to establish the principle that where an act of a State legislature by its terms directly conflicts with an express provision of an Act of Congress governing the operations of a Federal agency, the State law must give way before the paramount authority of the Federal Government.

In certain other cases, the Supreme Court appears to have proceeded upon a slightly different theory in holding the State law unconstitutional. In the early case of M'Culloch *v.* Mary-

to serve the Federal Government. The Waite Case is substantially to the same effect, the court saying in part (p. 533):

> "We have more than once held in this court that the national banks organized under the Acts of Congress are subject to the State legislation except where such legislation is in conflict with some Act of Congress or where it tends to impair or destroy the utility of such banks as agents or instrumentalities of the United States or interferes with the purposes of their creation."

[8] 161 U. S. 275.

[9] At p. 283.

land,[10] Chief Justice Marshall laid down the principle that a State statute taxing the operations of a national bank organized under an Act of Congress is unconstitutional and void, since it imposes a burden upon and interferes with the operation of an instrumentality of the National Government. Unlike the Deering Case and the Davis Case, however, the State law which here was held unconstitutional did not directly conflict with an express provision of the Act of Congress. It did, however, tend to burden and impede the operations of a national agency and for that reason it was held to be void. The court said in part:

> "The Court has bestowed on this subject its most deliberate consideration. The result is a conviction that the States have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general government. This is, we think, the unavoidable consequence of that supremacy which the Constitution has declared." [11]

In Easton *v.* Iowa,[12] the court proceeded upon much the same reasoning as in the M'Culloch Case. An Iowa statute prohibited the officer of an insolvent bank from accepting deposits after the insolvency of the bank and with knowledge of such insolvency. The defendant Easton, an officer of a national bank located in Iowa, accepted a deposit, knowing that the bank was insolvent. The Supreme Court of Iowa sustained a conviction under the Iowa statute. On appeal to the Supreme Court of the United States, this decision was reversed on the ground that, so far as national banks were concerned, the Iowa statute interfered with their operation and was in fact in conflict with the purpose of the National legislation. The court said, in part, relative to the National Bank Act:

> "The legislation has in view the erection of a system extending throughout the country and independent so far as powers conferred are concerned, of State legislation which if

[10] *Supra.*
[11] At p. 435.
[12] 188 U. S. 220.

permitted to be applicable might impose limitations and restrictions as various and as numerous as the States." [13]

There is yet another principle which the Supreme Court of the United States has enunciated and which bears upon the question at issue. It would appear that a State statute is unconstitutional, although it does not expressly conflict with an Act of Congress and although it does not necessarily burden the Federal instrumentality, if it is evident from the subject-matter involved and the extent of the Federal legislation that Congress intended that there should be no further legislation upon the subject-matter. In such a case as this, it is not competent for a State to supplement the provisions of the Federal statute by legislation of its own.[14] In the Prigg Case, the court said:

> "Where Congress have exercised a power over a particular subject given them by the Constitution, it is not competent for State legislation to add to the provisions of Congress upon that subject; for that the will of Congress upon the whole subject is as clearly established by what it has not declared, as by what it has expressed." [15]

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[13] At pp. 229, 230. The court cited M'Culloch *v.* Maryland, *supra*, and Osborne *v.* U. S. Bank, *supra*.

In connection with this line of decisions the case of Ohio *v.* Thomas, 173 U. S. 276, is interesting. In this case, the manager of an Old Soldiers' home located in Ohio was indicted and convicted under an Ohio statute for serving oleomargarine to the inmates of the home without displaying a placard stating that oleomargarine was being served, as required by the statute. It appeared that, pursuant to an Act of Congress, the Managers of the Home were required each year to furnish to the Secretary of War estimates in detail covering the necessary supplies for the Home. The Secretary of War in turn was required to include such estimates in the estimates for his Department. An Act of Congress also required that the appropriations for the support of this Home should include the cost of all articles purchased for the ration of the inmates. On appeal, the Supreme Court of the United States discharged the defendant. The court proceeded upon the ground that the Governor of the Home must be assumed to have submitted estimates to the Board of Managers, which in turn were submitted to the Secretary of War; that as these estimates must be assumed to have included oleomargarine among the rations to be furnished the inmates, Congress, in its appropriation for the support of the Home, provided in effect for oleomargarine as part of the rations; consequently the Governor in serving oleomargarine to the inmates was acting under the authority of Congress; hence the State had no power to interfere. It is interesting to note that Mr. Justice Harlan concurred in the judgment but not in all of the reasoning. However, although the court perhaps was led to make inferences of fact which the record did not justify, its conclusion seems to be in accord with the prevailing decisions.

[14] Houston *v.* Moore, 5 Wheat. 1; 21, 22; Prigg *v.* Pennsylvania, 16 Pet. 536, 618.

[15] At p. 618.

Yet on the other hand it cannot be denied that a national instrumentality, such as a national bank or a Federal reserve bank, is subject to a certain extent to the jurisdiction of the State in which it is located. It is perhaps governed in its daily course of business far more by the laws of the State than by those of the Nation. Its ordinary contracts are governed and construed by State law. Its acquisition and transfer of property, its right to collect debts, and its liability to be sued for debts are all based on State law. State fire laws, health laws, and construction laws apply to it as well as to any other corporation located within the State.[16] As was said in National Bank *v.* Commonwealth:[17]

> "It certainly cannot be maintained that banks or other corporations or instrumentalities of the government are to be wholly withdrawn from the operation of State legislation. * * *
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> "The agencies of the Federal government are only exempted from State legislation so far as that legislation may interfere with, or impair their efficiency in performing the functions by which they are designed to serve that government."

In Davis *v.* Elmira Savings Bank,[18] the court said, in speaking of national banks:

> "It is certain, that in so far as not repugnant to Acts of Congress, the contracts and dealings of national banks are left subject to the State law."

In view of the opinions expressed in the foregoing and other cases, it is perhaps impossible to draw a precise line between Federal and State control. A close analysis of these cases, however, and of the expressions of the court therein would seem at at least to warrant the following conclusions: Where Congress in the exercise of its constitutional authority has created an in-

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[16] In National Bank *v.* Commonwealth, 76 U. S. 353, Mr. Justice Miller said, in speaking of national banks (p. 362):

> "They are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation. All their contracts are governed and construed by State laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on State law. It is only when the State law incapacitates the banks from discharging their duties to the Government that it becomes unconstitutional."

See also Waite *v.* Dowley, 94 U. S. 527, and Note 1, *supra.*

[17] 76 U. S. 353, 361.

[18] *Supra.* At p. 287.

strumentality for the purpose of carrying into execution the constitutional powers of the National Government, a State law which attempts to control or regulate the operations of such an instrumentality is unconstitutional in so far as that instrumentality is concerned (1) where the State law substantially conflicts with or is repugnant to an express provision of the Federal legislation creating and defining the powers of the instrumentality; or (2) where the State law imposes a burden upon or impairs the effective execution of such of its operations as are necessary and proper for the efficient execution of the national purpose for which the instrumentality was created; or (3) where the State law attempts to supplement the legislation of Congress in a certain matter upon which the Federal legislation is silent but it is evident from the extent of the legislation that Congress intended there should be no further legislation with regard to the subject-matter. On the other hand, within certain limits, the national agency is subject to the general undiscriminating laws of the State within which it is located.[19]

Applying the above principles to the precise question at issue, the conclusion is not difficult to reach.

In the first place, the State usury laws are substantially in conflict with and repugnant to an express provision of the Act of Congress creating the Federal reserve banks. Although the Federal Reserve Act, unlike the National Bank Act, does not attempt to fix the maximum rates of interest or discount which a Federal reserve bank may charge, Sections 13 and 14 of that

[19] Mr. Justice White in Davis *v.* Elmira Savings Bank, *supra,* at p. 283, substantially stated the foregoing principles when he said:

> "National banks are instrumentalities of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States. If follows that an attempt by a State to define their duties or control the conduct of their affairs is absolutely void, wherever such attempted exercise of authority expressly conflicts with the laws of the United States, and either frustrates the purpose of the national legislation or impairs the efficiency of these agencies of the Federal government to discharge the duties, for the performance of which they were created. These principles are axiomatic, and are sanctioned by the repeated adjudications of this court."

But he was careful to add (p. 290):

> "Nothing, of course, in this opinion is intended to deny the operation of general and undiscriminating State laws on the contracts of national banks, so long as such laws do not conflict with the letter or the general objects and purposes of Congressional legislation."

Act expressly authorize the Federal reserve banks to establish interest and discount rates "subject to the review and determination of the Federal Reserve Board," and require that "they shall be fixed with a view to accommodating commerce and business". This delegation of power to fix rates is clearly within the authority of Congress.[20] The rates established in connection with the discount and loan operations of the Federal reserve banks are not fixed in any substantial sense for profit, but primarily with a view to exercising a certain control over the credit operations of the country so as to insure sound banking. Their purpose is national and nation-wide. For instance, in order efficiently to perform the functions for which these banks were created, it might be thought advisable to fix the interest and discount rate at a high level and uniform throughout the country so as to control a dangerous over-inflation of credit. If such rates were subject to the usury laws of the several States, this national policy could not possibly be effectuated, and one of the purposes for which the Federal reserve banks were organized and for which they were empowered to establish interest and discount rates would be utterly defeated.

Furthermore, the Act expressly provides that rates "shall be fixed with a view to accommodating commerce and business". The maximum rate allowed by State law might, and in fact in some cases does, directly conflict with the rates which, in the opinion of the Federal reserve banks and the Board, are necessary in order properly to accommodate business and commerce. If the State law prevailed, the banks would be unable to carry out a duty which Congress has expressly required of them. As was said by the court in First National Bank *v.* Garlinghaus: [21]

> "If the State can in derogation of the Act of Congress limit the capacity or the right of the bank as to the rate of interest it may charge, the State would seem to have plenary power over the whole subject and could so exercise it if it saw proper as to destroy for all practical purposes the value of its franchise."

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[20] Field *v.* Clark, 143 U. S. 649, 693; Butterfield *v.* Stranahan, 192 U. S. 470. 496.

[21] *Supra.*

In the second place, the usury laws of a State, when applied to the Federal reserve banks, impose a burden upon and impair the effective execution of operations which are strictly national in character. It may fairly be said that the power to fix rates of discount and interest is one of the most important functions of the Federal reserve banks. Through the fixation of such rates, the National Government is enabled to control and direct the credit operations of the country, thus insuring sound banking on a nation-wide scale. The act of a State in attempting to interfere with such national control clearly would impose a severe burden upon the operation of the Federal agency and seriously impair the effective execution of the national end for which the agency was created. As was said in Easton *v.* Iowa: [22]

> "It is not competent for State legislatures to interfere, whether with hostile or friendly intentions, with national banks or their officers in the exercise of the powers bestowed upon them by the general Government."

Finally, it cannot be denied that Congress in creating the Federal Reserve System has erected a symmetrical and complete plan for executing a national policy. It is manifestly evident, therefore, that Congress intended that there should be no further legislation with regard to those operations of the Federal reserve banks which are necessary in order to carry out effectively the end for which they were created. An attempt on the part of a State to supplement this legislation by imposing a maximum limit upon the rates of interest and discount which a Federal reserve bank may charge is an unwarrantable and unconstitutional interference with the national operations of a Federal agency. As was said by the Supreme Court in Prigg *v.* Pennsylvania: [23]

> "If Congress have a constitutional power to regulate a particular subject, and they do actually regulate it in a given manner, and in a certain form, it cannot be, that the State legislatures have a right to interfere, and as it were, by way of complement to the legislation of Congress, to prescribe additional regulations, and what they may deem aux-

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[22] *Supra.* At p. 234.
[23] *Supra.* At p. 617.

> iliary provisions for the same purpose. In such a case, the legislation of Congress, in what it does prescribe, manifestly indicates, that it does not intend that there shall be any further legislation to act upon the subject-matter. Its silence as to what it does not do, is as expressive of what its intention is, as the direct provisions made by it."

In view of these considerations, it may be safely said that the loan and discount operations of the Federal reserve banks are not subject to the State usury laws, and that the fixation of interest and discount rates rests exclusively with the Federal reserve banks, subject to the review and determination of the Federal Reserve Board. It should be remembered, however, that the national banks are subject to the provisions of the National Bank Act and that the State banks, whether members of the Federal Reserve System or not, must comply with the usury laws of the various States wherein they are located.

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